Marketing To Sophisticated Investors column

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When Your Service Provider Selection Can Create Asset Raising Problems

While back office service providers fill the necessary functions of everyday operations they do not do anything in their day-to-day work that can significantly improve a money management firm's ability to raise assets. The opposite, however — creating asset raising problems — is a more likely possibility.

Investment boutiques need to select and work with, among others, prime brokers, accounting, fund admin and law firms, as well as IT management businesses supporting transaction processing, portfolio reporting and the like. Investment firm owners are often advised to select 'name brand' back office service providers. This often means the largest of service companies with the widest array of services and abilities; but pricing must be considered when taking those characteristics into mind. After all, particularly for the emerging manager, the 'how much' issue and the 'who' issue must be balanced.

Buying what you can't really afford?

Smaller emerging managers are rarely in the position to need a 'full Monty' set of services early on. So, service providers that are not among the largest, and who also happen to have lower fees than the biggest in their fields, may be the smarter way to start out as emerging manager firm owners take steps to grow their assets.

But what if the emerging manager *does* pay for some of the bigger back office service provider names? They could find that they bought themselves a marketing problem by not having researched and selected 'good enough' providers.

When sophisticated investors conduct due diligence on a young money management firm one of the things they investigate from an operational due diligence perspective is how much financial runway the firm owners have given themselves to grow the business. For this, they examine its capitalization and its expense ratio from running its operations.

Having three to four years of runway is considered to be good. Having under two years of runway, based on firm capitalization, is a problem.

The smaller the AUM of an emerging manager, the greater the likelihood that the expense ratio will reveal that the firm owners who hired the biggest of names are spending more than what their current capitalization can afford. That expense, added to the costs of salaries, insurance and the like, shortens the runway an emerging manager has to meet growth objectives revenue-wise and be able to afford to stay in business.

Further, an emerging money management firm that is not well capitalized cannot just pass on very high expenses to investors. Too high an expense ratio can make prospects wary of an emerging manager's business management acumen, and for some family offices, that business risk alone would be a reason enough not to invest.

This is why marketing an emerging manager's decision to hire a bigger than affordable back office service provider — and investors can and will do a back-of-napkin calculation to see this — is likely to inhibit asset raising among sophisticated investors and their gatekeepers. They will see a perceived business risk because of the investment firm's now likely shorter than desirable runway.

So, the emerging manager needs to give serious consideration to this question: For how long can our young firm 'tread water' before it runs out of money to stay in business?

By researching and selecting 'good enough' providers, and communicating that in their sales marketing encounters with prospects, emerging managers can demonstrate they have a small business owner's head on their shoulders expense management-wise.

But that's still not all there is to it.

Who the money management firm gets assigned to work with them is not inconsequential. Generally speaking, the larger the service provider organization and the smaller (in AUM) the money management firm customer, the lower the level of staff — in depth and breadth of experience — that will be assigned as the account servicing contacts. Conversely, the smaller (by number of staff) rather than bigger back office service provider firms are more likely to assign more senior staff to service the money management firm.

How sophisticated investors will judge

Sophisticated investors are aware of the desire of emerging managers to buy credibility via their back office service provider selections, but they understand both the financial and service level trade-offs the emerging manager must make.

Generally, the more likely investment firm owners are to benefit from the counsel of most senior staff at back office service providers, the more their selection should be guided by which people with what level of experience will be their contacts. In the investors' eyes, the less experience the emerging manager has in running a business (not just trading securities), the more important this is. But does the manager show she or he understands this and seeks to align with those who have more experience and can be of most consultative use?

As a family office investor once commented to me, when in discussions with an emerging manager, an investor can glean from their dialogue whether the manager is simply trying to buy credibility by retaining a more than affordable back office without having thought through what he or she was or wasn't getting: the level of customer service attention, counsel and handholding and the timeliness of delivery of services; and whether they could both currently afford their back office service selections *and* have a long enough runway to give the money manager the potential to succeed.

The emerging managers who show they've made a thoughtful selection of back office service providers are more likely to avoid some of the perceived business risk marketing problems than some of their competitors. And that can become another differentiator and marketing edge.

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About the author

Bruce Frumerman is CEO of Frumerman & Nemeth Inc., a 38-year-old financial communications and sales marketing consultancy that helps financial services firms create brand identities for their organizations and develop and implement effective new marketing strategies and programs. Frumerman & Nemeth's work has helped money management firm clients attract over $7 billion in new assets, yet they are *not* third-party marketers.

Frumerman & Nemeth is internationally recognized for its work in crafting for clients the beyond-the-numbers story of how they invest — content that investment committees actually discuss, debate and vote on behind closed doors when considering firms on a short list for potential investment. Importantly, this is required due diligence content that cannot be communicated in pitchbook format.

Frumerman & Nemeth's work also includes providing strategic consulting on product and strategy-specific branding, crafting the required strategy-specific content detail and designing and producing the marketing tools needed to make it through the two-month to two-year institutional selling cycle. Clients also employ Frumerman & Nemeth to help promote the intellectual acumen of management — helping them get speaking opportunities, write and give speeches as panelists or stand-alone speakers at industry conferences, and through media relations marketing services.

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